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SENT BY MAIL/FAX/ELECTRONICALLY

September 9, 2002

Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, Massachusetts 02110

Re: Investigation by the Department of Telecommunications and Energy on its own Motion into the Provision of Default Service, D.T.E. 02-40

Dear Secretary Cottrell:

On June 21, 2002, the Department of Telecommunications and Energy ("Department" or "D.T.E.") opened an Investigation into the Provision of Default Service ("Default Service NOI"), which was docketed as D.T.E. 02-40. Pursuant to the comment schedule established by the Department at the Technical Session on August 9, 2002, several commenters (including the Attorney General) filed Initial Comments responding to the issues raised by the Department regarding the provision of Default Service. The schedule provided for Reply Comments, if any, to be filed on September 9, 2002 and by this letter, the Attorney General provides his Reply Comments.¹

¹ These Reply Comments are not intended to respond to every argument made or position taken by the commenters. Rather, they intended to respond only to the extent necessary to assist the Department in its deliberations, i.e., to provide further information, to correct misstatements or misinterpretations, or to provide omitted context. Therefore, silence by the Attorney General in regard to any particular argument, assertions of fact, or statement of
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I. INTRODUCTION

The Attorney General has reviewed the Initial Comments filed by the other parties and nothing in those comments has caused him to change the positions taken in his Initial Comments and Joint Principles. Indeed, although there may be limited steps the Department could take to change the procurement procedures for Default Service supply. Many of the suggestions offered by the other commenters are beyond the scope of a generic docket. The Department should only decide those issues within a separate adjudicatory proceeding so that it can base its determination on record evidence, not speculation.

In his Initial Comments, the Attorney General joined with NSTAR, the Massachusetts Community Action Program Directors Association, Inc. (“MASSCAP”), the Massachusetts Energy Directors Association, with strong support from the Utility Workers Union of America, AFL-CIO (“UWUA”), UWUA Local 369, and the Massachusetts Union of Public Housing Tenants in proposing a set of guiding principles and recommendations for the Department to apply to the various proposals offered in this proceeding. Attorney General Initial Comments, Att. A. Those principles and recommendations reinforce the Attorney General’s conclusion that any action taken by the Department to change the structure and procurement mechanism of Default Service must benefit consumers and retain the rights guaranteed to consumers in the Act.

A number of the proposals offered contain provisions that the Department cannot authorize without prior legislative action to amend the Electric Restructuring Act of 1997 (“Act”) St. 1997, c. 164. Therefore, in the interest of administrative efficiency and consistent with the Act, the Department should consider, albeit in separate adjudicatory proceedings, only those proposals that clearly fall within the statute.

The Department has expressed uncertainty about its statutory authority to implement certain types of changes, but indicated that it may use the results of this investigation to develop a report to the General Court on changes to Default Service.² The Department should develop such a report based on actual market experience and in response to a specific legislative inquiry, rather than as a general report based on economic conjecture. The Attorney General suggests that pilot programs, consistent with the Act, could be implemented to determine whether the various proposals result in lower, more stable Default Service rates for customers.

Finally, the Federal Energy Regulatory Commission (“FERC”) is currently considering two dockets, which, if implemented, will have a significant impact on the wholesale electricity markets in New England. See Notice of Proposed Rulemaking Remedying Undue Discrimination

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position in the Initial Comments should not be interpreted, construed, or treated as assent, acquiescence or agreement with such argument, assertion or position. The Attorney General may comment further on issues raised in the comments in a future technical session or adjudicatory proceeding.

² Default Service NOI, D.T.E. 02-40, p. 6.

through Open Access Transmission Service and Standard Electricity Market Design, Docket No. RM01-12-000, and *Joint Petition for Declaratory Order Regarding the Creation of a Northeastern Transmission Organization*, Docket No. RT02-3-000. The Department should, therefore, expand the scope of this proceeding to address FERC's final decision on standard market design. The Department must be careful to ensure that any structural reforms in the design and procurement of default electricity service in the Massachusetts retail electricity markets are consistent with final FERC wholesale market design.³

II. **DEFAULT SERVICE IS A SERVICE OF LAST RESORT THAT EXISTS FOR THE BENEFIT OF CUSTOMERS, NOT THE COMPETITIVE MARKET**

The Act presumed that competitive markets would occur as a natural outgrowth of restructuring, not through regulatory fiat or preferential treatment of competitive suppliers. That the competitive market for residential and small to and medium- sized commercial and industrial ("C&I") customers has not developed during the first few years of the transition period since the implementation of the Act is not an unanticipated outcome, and the development of such a market will not occur more quickly solely by changing the structure of Default Service procurement at the end of the transition period.⁴ If the Legislature had intended to connect the future of Default Service with the structure of the competitive market, it would have done so in the plain language of the statute.

Currently, the retail markets in the United States are in the developmental stages and no single market is operating successfully for all customers. The retail markets are intertwined with

³ It is critical to have an effectively competitive wholesale market that is working properly in place prior to the introduction of retail competition. The elements that should be present in the wholesale market include a transparent spot price that serves to increase reliability and inhibit market power as well as provide a price to evaluate the reasonableness of retail competitors' offers. *Making Competition Work in Electricity*, Sally Hunt, John Wiley & Sons, Inc. (2002), pp. 219-220.

⁴ Sally Hunt, a leading authority on how to make competition work, critiques the attempts made by states in constructing the "price to beat." Although she supports the use of shopping credits, she emphasizes that "[i]f the price to beat is too high, inefficient retailers with high costs relative to the utility's can compete. Since the utility loses more in revenues than it saves when a customer leaves, stranded costs are shifted to the utility's shareholders or to nonshopping customers." *Making Competition Work in Electricity*, Sally Hunt, John Wiley & Sons, Inc. (2002), p. 330. In addition, Ms. Hunt is highly critical of Ohio's shopping credit focus of setting credits that produce specific switching targets. "The Ohio approach defines success of retail access in terms of switching rates and makes arbitrary targets the primary goal at the expense of development of an efficient competitive market...[S]witching by retail customers is not a good test of whether there is a competitive market...the point is to give people the choice." *Id.*, p. 332. (Emphasis added).

the wholesale markets and changes to one effect the other. Wholesale electricity markets in the Northeast are functioning, but are still evolving, and both FERC and the regional Independent System Operators in New England (“ISO-NE”) and New York (“NYISO”) are proposing to implement sweeping changes to the wholesale markets. Given the potential magnitude of the proposed changes to the wholesale markets, it would be premature for the Department to take action that might cause the retail market to be in structural conflict with the wholesale market.

As envisioned by the Legislature in the Act, Default Service is a backstop service, not a competitive product or a means by which to measure the success or failure of the competitive markets.⁵ It is apparent that the desire to create competitive markets, not customer concerns, are the impetus for the suggestions to change to the pricing and procurement of Default Service. Indeed, most of the proposals offered to change Default Service focus on how to make it attractive to the competitive suppliers, not as a means to make Default Service attractive to customers who, for whatever reason, are on Default Service at the end of the transition period. Initial Comments of Massachusetts Electric Company (“MECo”), the Division of Energy Resources (“DOER”), PG&E National Energy Group (“NEG”), TXU Energy Retail Company LP (“TXU”), Western Massachusetts Electric Company (“WMECo”) and AES New Energy, Centrica North America, Green Mountain Energy, Strategic Energy, and TXU Energy Retail Company LP (together, “Competitive Retail Suppliers”). Moreover, none of the plans offered in this proceeding is based on actual market experience in the Massachusetts retail markets. If we implement such proposals without an evidentiary showing that these changes are in the public interest, we risk increased costs and confusion at customers’ expense.

III. THE DEPARTMENT SHOULD NOT RAISE RATES TO SPUR COMPETITION

A number of the plans presented to the Department would effectively raise rates to help achieve a competitive market for residential and small to medium sized C&I customers. Consistent with the Joint Principles, changes to Default Service, either in pricing or procurement, should be implemented only if they are in the public interest and benefit customers. Raising rates to achieve competition is not consistent with those principles.

DOER suggests that the Department needs to act quickly to address weaknesses in the manner in which companies price Default Service because it excludes supply-related costs from the price of the supply and that results in an anti-competitive subsidy and prevents fair competition. DOER Initial Comments, p. 4. DOER also states that the six-month price option provides the illusion of meaningful price stability or certainty. *Id.* To address these so-called structural weaknesses with Default Service pricing, DOER advocates a pricing regime that would

⁵ “Default Service”, is defined as “the electricity services provided to a retail customer upon either the (i) failure of a distribution company or supplier to provide such electricity services as required by law or as contracted for under the standard service offer, (ii) the completion of the term of the standard service offer, or (iii) upon the inability of a customer to receive standard service transition rates during the term of the standard service offer pursuant to section 1B. G.L. c. 164, § 1.

in effect raise prices to spur competition, not as a means to provide a low-cost reliable generation supply. DOER envisions a mechanistic approach to procurement that it hopes will have the effect of driving customers into the competitive market, regardless of whether such a market exists to serve them and regardless of customer concerns about the desirability of purchasing service in the competitive market.⁶

The DOER plan acknowledges that there are few, if any, competitive options available for the majority of ratepayers, and that Default Service will probably continue to be the service-of-choice after the end of the standard offer period. DOER Initial Comments, p. 15. Yet, despite this market probability, DOER's plan attempts to jump-start the competitive market by artificially creating competition through regulatory manipulation. The Department should not simply throw customers, real people and businesses that are struggling under current economic conditions to survive, make ends meet, and provide for all who depend on them, out to a competitive market that may or may not be able to serve them.

Similarly, MECo presented a plan to the Department that would result in a basic service retail rate that would potentially yield rates that are considerably higher than the DOER plan. MECo Initial Comments, p. 17. In addition, a central component of MECo's plan is predicated on action that is prohibited under the Act - slamming customers. G.L. c. 164, § 1(F)(8) and 940 C.M.R. § 19.06.

WMECo suggests that distribution companies should be able to collect a "service fee" on the energy they provide as the Default Service provider to compensate the distribution company for its efforts in securing Default Service, to better mimic a retail price and to eliminate the so-called market distortion inherent in the wholesale price option for retail customers. WMECo Initial Comments, p. 6. In other words, WMECo seeks to raise its Default Service price to compensate itself for what is supposed to be a pass-through service, under the guise of putting Default Service pricing on a retail basis.

The Department should not approve any plan that would raise rates for customers simply to foster competition. In addition, the Department should not approve any plan without benefit of an adjudicatory hearing.

IV. CHANGES TO THE PROCUREMENT OF DEFAULT SERVICE SUPPLY SHOULD BE APPROVED ONLY ON A VOLUNTARY BASIS THROUGH PILOT PROGRAMS

The Department's inquiry into the provision of Default Service could benefit from actual market experience. The proposal offered by MECo contains some provisions, such as longer-term procurements and pricing provisions, that should be tried on a voluntary basis as part of a pilot program. Aside from the proposal to assign customers, which is slamming and prohibited,

⁶ DOER seeks to "realign customer focus in regard to power supply issues from distribution companies to competitive suppliers." DOER Comments, p. 16.

the Department should consider implementing MECo's proposal after full investigation and adjudication of all aspects of the program.

The DOER proposal also has merits (longer term and staggered procurements), but the proposed 1/8 load procurement slices pose unnecessary administrative burdens and may serve to raise costs without providing any additional benefits. As recommended for the MECo proposal, the Department could implement DOER's proposal as a voluntary pilot program, but only after a full investigation and adjudication.

V.. SUPPLIER INTERFACE WITH CUSTOMERS MUST COMPLY WITH THE PROVISIONS OF THE ACT

One of the basic tenets of the Act is the freedom to choose a supplier. St. 1997, c. 164 (1) (c) (ii). The freedom to choose also includes the right not to choose. DOER recommends that the Department require distribution companies to make changes to their Default Service approach that would facilitate customer interaction with Default Service suppliers by requiring Companies to inform their Default Service customers of the identity of the power supplier.⁷ DOER Initial Comments, p. 7. While it may be worthwhile for a customer to have that knowledge, DOER's proposal to force a customer/company relationship where none in fact exists will cause unnecessary confusion and likely erode enthusiasm for and confidence in electric restructuring. By statute, the Default Service relationship exists between a distribution company and a customer, unless the Department authorizes an alternative supplier to step into the shoes of the distribution company. G.L. c. 164, 1(B)(d).

In an effort to have customers identify with suppliers more directly, some commenters offer the Department suggestions that would circumvent both the law and the Department's own conclusions. TXU's proposal would require that the Department circumvent the legislative prohibition against competitive billing in section 312 of the Act, by requiring utilities to file tariffs for all retail services, including billing services. TXU Initial Comments, p. 29. TXU concludes that the utilities would continue to "create and send bills to customers" as required by G. L. c. 164, § 1D, but that the retailer would own the content and format of the bill and could simply change it to fit the retailer's business goals. Id.

Rather than focus on the development of a relationship between a customer and a temporary provider of default energy, one that may not be capable or interested in serving the customer on an individual basis, the Department should foster the development of continuing customer education programs. Customers have few sources of information about the changing regulatory environment, how energy services are now provided, the significant changes looming

⁷ DOER would designate each Default Service supplier as the "Power Supply Representative" for that portion of the distribution company's customers commensurate with the supplier's portion of the Default Service Load. The Power Supply Representative would be required to operate a toll-free number to respond to customer inquiries about Default Service. DOER Initial Comments, p. 7.

on the horizon and how these changes may affect their cost for electricity and what options they have. Since the initial stages of retail access, when DOER introduced its customer education brochure and staffed a hot line, little, if any, effort has been made to educate customers about changes to the industry. Consumers cannot be expected to embrace retail choice unless they are confident they are able to make correct decisions based on understanding the electricity market in Massachusetts.⁸

VI. COST UNBUNDLING

Several commenters propose to move generation procurement and administrative costs from distribution rates and include these avoidable costs in the Default Service rate. DOER Initial Comments, p. 27, MECo Initial Comments, p. 34. Other commenters support the use of adders⁹ to utility generation service charges to expose customers to the “full” cost of providing Default Service and thereby facilitate the development of a retail competitive market.

While the further unbundling of rates for the purpose of allowing customers to see the full cost of the service being provided is not an undesirable exercise, the task should not be to expose only customers to the full costs of providing generation service. Competitive suppliers also should be responsible for the costs of services provided by the utilities that normally, in competitive markets, they would have to provide for themselves at a cost. The Competitive Retail Suppliers acknowledge the inequity of the subsidy provided retail marketers, that competitive suppliers should be responsible for billing their customers and, as long as utilities continue to perform the billing function, utilities should charge the suppliers for the service under Department approved tariffs. Competitive Retail Suppliers, Initial Comments, p. 5. Billing costs are not the only subsidy provided to suppliers. Utilities provide load forecasting, profiling and reporting services on behalf of suppliers, as well as customer service functions, including payment allocation and remittance services. The Department should reconsider its decision in Default Service, D.T.E. 99-60-B, pp.16-19, (2000), where it determined that it was not beneficial to unbundle energy procurement charges and related bad debt costs because the level of these

⁸ The Connecticut Department of Public Utility Control issued a Joint Study with the Office of Consumer Counsel Regarding Electric Deregulation and How Best to Provide Electric Default Service After January 1, 2004 on February 15, 2002 (“Connecticut Study”). The key role customer education plays in the successful implementation of retail competition was highlighted. “Key barrier faced by suppliers is the customer’s lack of understanding regarding restructuring as well as a limited knowledge as to the operation of the electric infrastructure.” Comments go on to state that market research finds that “...residential customers are concerned that switching from their host utility will increase the risk that their service will be terminated in the event that their supplier goes bankrupt or if a supplier’s source of electricity fails.” Connecticut Study, p.8. This could be a significant concern given the financial condition of some of the commenters in this proceeding.

⁹ “Adders” are artificial costs added to Default Service rates to replicate either costs to procure and administer the Default Service program or to approximate some of the cost that marketers incur to service retail customers above the cost of power.

costs was minimal. The D.T.E. should open an investigation into which specific costs should be removed from the utilities' current distribution rates for both generation services and supplier services.

VII. THE DEPARTMENT SHOULD DEFER ANY CHANGES TO ADJUST FOR LOCATIONAL MARGINAL PRICING

Commenters raised the issue of whether Default Service prices should reflect locational marginal prices when this pricing scheme is introduced by ISO-NE as part of the new SMD scheduled for implementation at the end of this year. Several commenters suggested that zonal LMP based pricing should be used for large industrial customers while average pricing should be retained for small customers (DOER Initial Comments, pp. 33-35, WMECo Industrial customers, p. 4, Competitive Retail Suppliers Initial Comments, p. 6, MECo Initial Comments, p. 34 (for large C&I customers)). Rather than decide this issue before LMP has been implemented and all related pricing rules, policies and procedures have been finalized at the wholesale level, the Department should defer deciding this issue until all the facts and ramifications are known or may be estimated with a high degree of certainty. It is premature to adopt zonal pricing for any group of customers at this time and the result could be serious unanticipated adverse economic consequences, as well as customer confusion and further disillusionment with restructuring. Customers have been paying rates designed to recover costs of a system based on reliability and zonal energy prices are designed to foster the development of a system that is based on competitive markets.

VIII. CONCLUSION

The Department should not make major structural changes to the procurement and pricing of Default Service merely to spur the establishment of a competitive retail market in Massachusetts for residential and small to medium-sized C&I customers. Moreover, the Department should implement any changes through pilot programs after full investigation and adjudication. Finally, the Department should not take any action that will conflict with pending changes to the wholesale electricity markets.

The Attorney General requests that the Department adopt the Joint Principles submitted by the customer representatives and NSTAR. Thank you for the opportunity to submit these comments.

Sincerely,

Judith Laster
Assistant Attorney General

cc: Jeanne Voveris, Hearing Officer,
Electronic Service List